22.1.0 Definitions

22.1.1 Income

Self-employment income means income directly from one's own business rather than as an employee with a specified salary or wages from an employer.

22.1.2 Business

Business means an occupation, work, or trade in which a person is engaged as a means of livelihood.

22.1.3 Operating

A business is operating when it is ready to function in its specific purpose. The period of operation begins when the business first opens and generally continues uninterrupted up to the present. A business is operating even if there are no sales and no work is being performed. Thus a seasonal business operates in the off season unless there's been a significant change in circumstances (22.5.3).

A business isn't operating when it can't function in its specific purpose. For instance, if a mechanic can't work for 4 months because of an illness or injury, he may claim his business wasn't in operation for those months.

22.1.4 IM Income

IM income means self-employment income that is counted in determining economic assistance eligibility and benefits.

22.1.5 Real Property

Real property means land and most things attached to the land, such as buildings and vegetation.

22.1.6 Nonreal Property

Nonreal property means all property other than real property.

22.2.0 Ways to Identify

Identify a farm or other business according to the following criteria.

22.2.1 By Organization

A farm or other business is organized in 1 of 3 ways:

1. A sole proprietorship, which is an unincorporated business owned by one person.

22.2.1 By Organization

2. A partnership, which exists when 2 or more persons associate to conduct business. Each person contributes money, property, labor, or skills, and expects to share in the profits and losses. Partnerships are unincorporated.

3. A corporation is a legal entity authorized by a state to operate under the rules of the entity's charter. There may be one or more owners. A corporation differs from the other forms because a corporation:

a. Is taxed as a separate entity rather than the owners being taxed as individuals, and

b. Provides only limited liability. Each owners' loss is limited to their investment in the corporation while the owners of unincorporated business is also personally liable.

22.2.2 By IRS Tax Forms

A self-employed person who earns more than $400 net income must file an end-of-year return. A person who will owe more than $400 in taxes at the end of the year must file quarterly estimates.

IRS tax forms for reporting self-employment income are listed below.

1. Form 1065 - Partnership
2. Form 1120 - Corporation
3. Form 1120S - S Corporation
4. Form 4562 - Depreciation & Amortization
5. Form 1040 - Sole Proprietorship
    a. Schedule C (Form 1040) - Business (nonfarm)
    b. Schedule E (Form 1040) - Rental and Royalty
    c. Schedule F (Form 1040) - Farm Income
    d. Schedule SE (Form 1040) - Social Security Self-Employment

22.2.3 Employee Status

A person is an employee if s/he is under the direct "wield and control" of an employer. The employer has the right to control the method and result of the employee's service. A self-employed person earns income directly from his/her own business, and:

22.2.3 By Employee Status (cont.)

1. Does not have federal income tax and FICA payments withheld from a paycheck.

2. Does not complete a W-4 for an employer.

3. Is not covered by employer liability insurance or worker's compensation.

4. Is responsible for his/her own work schedule.

Examples of self-employment are:

1. Businesses that receive income regularly (for example, daily, weekly or monthly):

    a. Merchant.
    b. Small business.
    c. Commercial boarding house owner or operator.
    d. Owner of rental property.

2. Service businesses that receive income frequently, and possibly, sporadically:

    a. Craft persons.
    b. Repair persons.
    c. Franchise holders.
    d. Subcontractors.
    e. Sellers of blood and plasma.
    f. Commission sales persons (such as door-to-door delivery).

3. Businesses that receive income seasonally:

    a. Summer or tourist oriented business.
    b. Seasonal farmers (custom machine operators).
    c. Migrant farm worker crew leaders.
    d. Fishers, trappers, or hunters.
    e. Roofers.

4. Farming, including income from cultivating the soil, or raising or harvesting any agricultural commodities. It may be earned from full-time, part-time or hobby farming.

22.3.0 Assets

22.3.1 Business Assets

Business assets are generally income producing property. Exclude assets directly related **and** essential to producing goods or services.

22.3.1.1 EBD

In EBD cases, all real and nonreal business property is exempt if the business is currently operating (22.1.3) for the self-support of the EBD individual. There is no profitability test.

Ask the EBD person to furnish the documents (22.2.2) needed to:

1. Describe the business, its properties, and its assets.

2. Show the number of years it has been operating.

3. Identify any co-owners.

4. Show the estimated gross and net earnings for the current tax year.

If the property is not currently operating, exempt it if there is reasonable expectation it will resume operating within the next 12 months. Base your reasonable expectation on the following information:

1. Date of last use.
2. Reason property is not in current use.
3. Estimated date the person expects to resume use.

If s/he decides not to resume, the property becomes a countable asset in the month after the decision not to resume.

Extend the 12 months only when a disabling condition prevents the person from resuming business use of the property.

22.3.2 Bank Accounts

With corporations you can easily distinguish between personal and business checking and savings accounts. A corporation is a separate legal entity and the accounts it owns must be in the corporation's name. Accounts in the name of the owners are personal accounts.

22.3.2 Bank Accounts (cont.)

For partnerships and sole-proprietorships, a cash account is a business account if the person claims that it is a business account. Disregard a business account, if the profitability test is passed, even if a partner or sole-proprietor makes withdrawals from the account for personal use. You don't need a profitability test for EBD cases.

22.4.0 Income

All self-employment income is earned income, except royalty income and some rental income (22.4.1).

Self-employment income is income that is reported to IRS as farm or other self-employment income or as rental or royalty income. When income isn't reported to IRS, you must judge whether or not it is self-employment income.

22.4.1 Income Sources

Self-employment income sources are:

- **Business**. Income from operating a business.

- **Capital Gains**. Income from selling securities and other property.
- **Rental**. Rental income is rent received from properties owned or controlled. Rental income is either earned or unearned. It is earned only if the owner actively manages the property on an average of 20 or more hours per week. It is unearned when the owner reports it to the IRS as other than self-employment income.

  Use "net" rental income in the eligibility determination. "Net" rental income means gross rental receipts minus business expenses.

  When the owner isn't an occupant, net rental income is the rent payment received minus the interest portion of the mortgage payment and other verified operational costs.

  When a life estate (11.8.1.5) holder moves off the property and the property is rented, net rental income is the rent payment received minus taxes, insurance, and operational costs. The operational costs are the same as the costs the holder was liable for when living on the property.

22.4.1 Income Sources (cont.)

When the owner lives in one of the units of a multiple unit dwelling, compute net rental income as follows:

1. Add the interest portion of the mortgage payment and other operational costs common to the entire operation.
2. Multiply the number of rental units by the total in step 1.
3. Divide the result in step 2 by the total number of units, to get the proportionate share.
4. Add the proportionate share to any operational costs paid that are unique to any rental unit. This equals total expenses.
5. Subtract total expenses from the total rent payments to get net rent.

- **Royalties**. Royalty income is unearned income received for granting the use of property owned or controlled. Examples are patents, copyrighted materials or a natural resource. The right to income is often expressed as a percentage of receipts from using the property or as an amount per unit produced.

22.5.0 Calculating IM Income

Calculate IM income (22.1.4) by either:

1. Using IRS tax forms completed for the previous year, **or**
2. Anticipating earnings (22.5.3).

22.5.1 IRS Tax Forms

Don't fill out any IRS tax forms (or the Self-Employment Income Report Form-DES 2131) yourself. This is the responsibility of the client.

Consult IRS tax forms only if:

1. The business was in operation at least one full month during the previous tax year, **and**
2. The business has been in operation six or more months at the time of the application, **and**
3. The person doesn't claim a change in circumstances since the previous year.

22.5.1 IRS Tax Forms (cont.)

If all three conditions aren't met, use anticipated earnings (22.5.3).

22.5.2 Worksheets

If you decide to use IRS tax forms, use them together with the self-employment income worksheets (DES 3132-3135).

The worksheets identify net income and depreciation by line on the IRS tax forms.

For each operation, select the worksheet you need and, using the provided tax forms and/or schedule, complete the worksheet. These are:

1. **Sole Proprietor - Farm and Other Business**
   a. IRS Schedule C (Form 1040) – Non-farm Business Income
   b. IRS Schedule E (Form 1040) - Rental and Royalty Income
   c. IRS Schedule F (Form 1040) - Farm Income
   d. IRS Form 4797 - Capital & Ordinary Gains
2. **Partnership**
   a. IRS Form 1065 - Partnership Income
   b. IRS Schedule K-1 (Form 1065) - Partner's Share of Income
3. **Corporation**

   IRS Form 1120 - Corporation Income
4. **Subchapter S Corporation**
   a. IRS Form - 1120S - Small Business Corporation Income
   b. IRS Schedule K-1 (Form 1120S) - Shareholder's Share of Income

Next, divide IM income by the number of months that the business was in operation during the previous tax year.

22.5.2 Worksheets (cont.)

The result is monthly IM income. Add this to the fiscal test group's other earned and unearned income. If monthly IM income is a loss, add zero to the non self-employment income.

When a household has more than one self-employment operation, the losses of one may be used to offset the profits of another. Apply this offset only to those self-employment operations that produced **earned** income. Don't apply a loss from unearned income to a gain in earned income. Losses from self-employment can't be used to offset other earned or unearned income.

If you use more than one worksheet because there is more than one operation, combine the results of each worksheet into one monthly IM income amount before adding that total to any other income. Remember that while a salary or wage paid to a FTG member is an allowable business expense, you must count it as earned income to the payee.

Continue to process the group through the balance of the handbook, including the Employment Expenses Unit. The additional work-related expenses cover personal expenses the IRS doesn't allow as business expenses.

22.5.2.1 Depreciation

EBD persons must deduct depreciation from their self-employment income. The amount of the depreciation deduction is the same as the amount they claim on their tax forms.

For **Family Medicaid**, do not allow the following deductions when calculating gross self-employment income:

1. Depreciation (also called depletion or amortization).
2. Transportation to/from work.
3. Purchase of capital equipment.
4. Payment on the principal of loans for capital assets or durable goods.

If using an IRS form (22.2.2) provided by the client, add depreciation back into the net income indicated on the form. The reason is the IRS allows depreciation as an income deduction but Family MA does not.

22.5.3 Anticipating Earnings

If past circumstances don't represent present circumstances, calculate self-employment income on anticipated earnings. A change in circumstances is any change that can be expected to affect income over time. It is the person's responsibility to report changes.

The date of an income change is the date you agree that a change occurred. You must also judge whether the person's report was timely to decide if the case was over or underpaid. Changes are then effective according to the normal retrospective budgeting cycle. Don't recover payments made before the agreed on date.

Other instances when you would use anticipated earnings:

1. The business wasn't operating at least one full month during the previous tax year.

2. The business wasn't operating six or more months at the time of the interview.

Examples of changed circumstances are:

1. The owner sold or simply closed down the business.
2. The owner sold a part of his business (e.g., one of two retail stores).
3. The owner is ill or injured and will be unable to operate the business for a period of time.
4. A plumber gets the contract on a new apartment complex. The job will take nine months and his/her income will increase.
5. A farmer suffers unusual crop loss due to the weather or other circumstances.
6. There's a substantial cost increase for a particular material such that there will be less profit per unit sold.
7. Sales, for an unknown reason, are consistently below previous levels. The relevant period may vary depending on the type of business (consider normal sales fluctuations).

22.5.3 Anticipating Earnings (cont.)

To anticipate earnings:

1. Average IM income over the past months beginning when circumstances changed if six or more months have passed since the change.

2. Calculate a cumulative monthly average when the change was less than six months ago, and when a new business has been operating less than six months.

3. Use the six months' average until the person reports a completed IRS tax form or reports a change in circumstances at review or between reviews.

The Self-Employment Income Report Form (SEIRF) (DES 2131) simplifies reporting income and expenses when earnings must be anticipated. It's modeled after IRS Form 1040, Schedule C, and can be used to report income for any type of business with any form of organization. However, some, especially farm operators, may find it easier to complete the IRS tax form when income and expense items are more complex.

To compute anticipated earnings, the person must complete a SEIRF for those months of operation since the change in circumstances occurred (remember, the beginning of a business is a change in circumstances). S/he may complete the SEIRF for each month separately or aggregate the months on one SEIRF.

1. For six or more months of operation since the change, calculate monthly average IM income and use it for the rest of the year.

2. For changes in months one through five, calculate monthly average IM income and the cumulative monthly average over six months of operation.

3. For less than one month of operation since the change, the person must estimate income and expenses for the next two months on a SEIRF. Divide the estimate by two to get monthly IM income for the first two months. Next, calculate the cumulative monthly average over six months of operation.

22.5.3 Anticipating Earnings (cont.)

When there are less than six months of operation:

1. The person must complete a SEIRF for each month of operation and mail each SEIRF until s/he has reported six months of operation.

2. You must keep a cumulative monthly average of the IM income reported until the average covers six months.

   For example, at review, the person reports three months of operation and then receives and completes three SEIRFs. Total the IM income from the three SEIRFs and divide the total by three to get a monthly average. When you receive the fourth SEIRF:

   a. Add the IM income for the fourth month to total IM income for the first three months.

   b. Divide the result in a. by four to get the new cumula-tive monthly average.

22.6.0 Verification

Accept self-declaration of farm and self-employment income, except when any item is questionable (37.4.0).

If questionable, completed and signed IRS tax forms (22.2.2) are sufficient verification of farm and self-employment income. If anticipated earnings are used, a completed and signed SEIRF is sufficient verification.

It isn't necessary to collect copies of supportive items such as receipts from sales and purchases. However, you can require verification when the information given is in question. Document the reason for the request.

22.7.0 Self-Employment Hours

Count the time a self-employed person puts in on business related activities involving planning, selling, advertising, and management along with time put in on production of goods and providing of services as hours of work.